

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Contact Person: [REDACTED]

Date 7-29-98

Telephone Number: [REDACTED]

Signature [REDACTED]

(202) [REDACTED]  
In Reference to:

OP: E: EO: T: 3  
Date:

JUL 23 1998

Employer Identification Number: [REDACTED]  
Key District Office: Ohio (Cincinnati)

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were originally incorporated under the laws of [REDACTED] on [REDACTED], [REDACTED]. Your stated purpose was to "Make interest free loans to needy individuals in the [REDACTED], and [REDACTED], [REDACTED] Communities, and all legal activities incident thereto." You subsequently amended your articles to limit your stated purposes exclusively to those described in section 501(c)(3) of the Code.

To carry out your purposes you have stated that you will solicit contributions from, and, make interest free loans to, members of the Jewish community in [REDACTED] and [REDACTED], [REDACTED], which community is primarily though not exclusively, made up of approximately 600 religiously observant (or orthodox) Jewish families.

The lending criteria for this relatively small group of possible borrowers are somewhat fluid. Such borrowers may include a person who may have lost their job and may have found work a short time later; but during the period of unemployment, savings were exhausted and numerous bills needed to be paid. This person would not be eligible for any government assistance and would not qualify for bank loans. Your role would be to provide this person with a temporary loan so that the bills could be paid and the person could re-establish their financial position. You state that these individuals are classified for loan purposes as "needy". Sudden medical emergencies, or the need for help in starting a business in order to be self-sufficient are among the reasons for considering making loans. You state that in all cases, the borrower is not asked to demonstrate objective signs

[REDACTED]

of need. It is enough that the potential borrower indicates that a need exists.

You explain that while need is based on the borrower's own representations (usually verbal), to assure repayment of the loan, you will require the borrower to execute a promissory note which requires level monthly payments, together with "head checks", and the borrower must furnish a guaranty signed by another member of the community or a close relative.

You have said that your loan committee will follow-up and determine whether loans are used for their stated purpose. If it is determined that loan proceeds have been misused, then you would attempt to recover the loan as soon as possible [after] the impropriety is discovered.

You state that you make the public aware of your existence and activities by word-of-mouth and advertising in local school and synagogue publications. Since your existence would likely be unknown outside your community, it is unlikely that a person who is not Jewish would seek to borrow funds from you. However, you do not have a policy against lending to people who are not Jewish.

Your source of support will be "100% private contributions from individuals". Your Board of Directors will approach private individuals and make requests for funds. The individuals would be told of the nature of the organization and what it will attempt to do. You are hoping for approximately 20 donors per year.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable or educational purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled by such private interests.

Section 1.501(a)-1(c) of the regulations defines "private shareholder or individual" as persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted sense and such term includes relief of the poor and distressed or of the underprivileged.

Rev. Rul. 56-304, 1956-2 C.B. 306, provides that organizations privately established and funded as charitable foundations which are organized and actively operated to carry on one or more of the purposes specified in section 501(c)(3) of the Internal Revenue Code of 1954, and which otherwise meet the requirements for exemption from Federal income tax are not precluded from making distributions of their funds to individuals, provided such distributions are made on a true charitable basis in furtherance of the purposes for which they are organized.

In Rev. Rul. 56-403, 1956-2 C.B. 307, it was held that the awarding of scholarships by a foundation solely to undergraduate members of a designated fraternity would not preclude it from exemption under section 501(c)(3) of the Code as an educational organization inasmuch as there was no specific designation of persons eligible for scholarships and the purposes of the foundation were not so personal, private, or selfish in nature as to lack the elements of public usefulness and benefit which are required of organizations qualifying for exemption under section 501(c)(3).

Rev. Rul. 64-274, 1964-2 C.B. 141, held that a corporation organized and operated on a nonprofit basis that provided worthy and needy students with free housing facilities and with funds for the purchase of books and instructional supplies or equipment on a gift, or loan basis, without interest, was exempt under section 501(c)(3) of the Code.

Rev. Rul. 69-175, 1969-1 C.B. 149, it was held that a nonprofit organization, formed by parents of pupils attending a private school, that provided school bus transportation for its members' children served a private rather than a public interest and did not qualify for exemption under section 501(c)(3) of the Code.

Rev. Rul. 69-441, 1969-2 C.B. 115, held that a nonprofit organization formed to help reduce personal bankruptcy by informing the public on personal money management and aiding low-income individuals and families with financial problems was exempt under section 501(c)(3) of the Code.

Rev. Rul. 74-587, 1974-2 C.B. 162, held that a nonprofit organization formed to relieve poverty, eliminate prejudice, reduce neighborhood tensions, and combat community deterioration through a program of financial assistance in the form of low-cost or long-term loans to, or the purchase of equity interests in, various business enterprises in economically depressed areas was exempt under section 501(c)(3) of the Code.

The private benefit prohibition of section 501(c)(3) of the Code applies to all kinds of persons and groups, not just those "insiders" subject to the more strict inurement proscription. Prohibited private benefit may include an "advantage; profit; fruit; privilege; gain or interest." Retired Teachers Legal Defense Fund v. Commissioner, 78 T.C. 280, 286 (1982).

An organization is not operated exclusively for charitable purposes, and thus will not qualify for exemption under section 501(c)(3), if it has a single non-charitable purpose that is substantial in nature. This is true regardless of the number or importance of the organization's charitable purposes. Better Business Bureau v. United States, 326 U.S. 278 (1945); Stevens Bros. Foundation, Inc. v. Commissioner, 324 F.2d 633 (8th Cir. 1963), aff'd, 39 U.S. 93 (1962), cert. denied, 376 U.S. 969 (1964). Operating for the benefit of private parties who are not members of a charitable class constitutes such a substantial nonexempt purpose. Old Dominion Box Co., Inc. v. United States, 477 F.2d 340 (4th Cir. 1973), cert. denied, 413 U.S. 910 (1973).

An organization will not qualify for exemption under IRC 501(c)(3) if its net earnings inure to the benefit of shareholders or individuals. In The Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969), cert. denied, 397 U.S. 1009 (1970), the court, without considering the organization's beliefs, held that it did not qualify for exemption under IRC 501(c)(3) because its net earnings inured to the organization's founder and family. See also, People of God Community v. Commissioner, 75 T.C. No. 8 (1980); Bubbling Well Church of Universal Love, Inc. v. Commissioner, 74 T.C. 531 (1980); Unitary Mission Church of Long Island, Inc. v. Commissioner, 74 T.C. 507 (1980); Western Catholic Church v. Commissioner, 73 T.C. 196 (1976); The Basic Unit Ministry of Schurig v. U.S., 31-1 USTC 9188 (D. D.C. 1981); Church of the Transfiguring Spirit, Inc. v. Commissioner, 76 T.C. 1 (1981).

Gifts by a charitable organization to friends and relatives of persons in control of the organization are personal in nature

rather than public. The recipients are natural objects of the "donor's" bounty. Therefore, by aiding them the organization is serving the insider's private purposes. This is true even though the recipients may be needy

It is well established that a charitable organizations can give money, goods, or services to individuals without losing its exempt status. Many forms of charity involve aid to individuals. Help to poor people and to deserving students are traditional examples.

Providing interest free-loans to members of a community is not per se a charitable activity. As with any endeavor sought to be classified as a charitable activity, the activity must itself be charitable, or, the activity, if not charitable, must be conducted primarily for the benefit of a charitable class. You have described your loan program as distinct from commercial loan programs only by the interest-free facet of your program. This interest-free feature without more cannot transform your loan program into a charitable activity.

Unlike the organization discussed in Rev. Rul. 69-441, you do not provide information or counseling to the public or the members of the community on budgeting, buying practices, or the sound use of consumer credit. Also, unlike the organization discussed in Rev. Rul. 74-587, you have not established that your interest-free loan program lessens prejudice and discrimination against a minority group, or, that your operations are in an impoverished area, or that you are otherwise relieving poverty and lessening neighborhood tensions, or combatting community deterioration.

While providing low interest or interest-free loans to members of a charitable class may come within the scope of relief of the poor and distressed or the underprivileged, you have failed to establish that the 600 or so families in the area that you will serve are members of a recognized charitable class, or that the making of interest-free loans to this group is a charitable activity benefiting the needy, poor, indigent, or destitute individual as contemplated by the statute. The potential recipient's classification as a member of such a class is dependent solely on the assertion of the member that a loan is needed. Like the organization discussed in Rev. Rul. 64-274, objective criteria must be used to establish merit or need for the services of a charitable organization.

While your proposed activities may be charitable in nature, the eligibility criteria (verbal assertion by potential borrower that need exists, with no further objective criteria or "needs test"); the proposed source of your funding (100% private contributions from individuals); and the limited publication of your activities (local schools and synagogues); are all factors which indicate a private rather than a public purpose is being served. Serving the interests of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose that precludes exemption under section 501(c)(3). See, Old Dominion Box Co. v. United States, cited above.

Unlike the organizations discussed in Rev. Rul. 56-304, which were privately established and funded, and made distributions on a truly charitable basis, you have not established that the population that you will serve is a charitable class or that your distributions will be for charitable or educational purposes. Furthermore, as discussed in Rev. Rul. 56-403, your activities lack the elements of public usefulness and benefit which are required of organizations qualifying for exemption under section 501(c)(3) of the Code.

Like the individuals discussed in Rev. Rul. 69-175, you have associated to provide a cooperative-type service for yourselves, thereby serving the private interests of the members of the group.

Because we believe that you are operated for the substantial nonexempt purpose of benefitting private parties who are not members of a charitable class, and you have not otherwise established that you operate for an exclusively charitable or educational purpose, we can not recognize you as exempt under section 501(c)(3) of the Code.

Contributions to you are not deductible under section 170 of the Code.

You are required to file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be

[REDACTED]

represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key district office. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service  
Attn: OP:E:EO:T:3 JC Rm. 6137  
1111 Constitution Ave, N.W.  
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Signed: [REDACTED]

[REDACTED]  
Chief, Exempt Organizations  
Technical Branch 3